MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BBF3284 – INTERNATIONAL FINANCE

(All sections/Groups)

21 OCTOBER 2017
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 3 pages with 1 Section only.
2. Answer **ALL** questions.
3. The distribution of the marks for each question is given at the end of each question.
4. Please write your answers in the Answer Booklet provided.

INSTRUCTION: ANSWER ALL QUESTIONS (100 MARKS)

QUESTION 1

As Foreign Currencies Swing, CFOs Hedge

By

Nina Trentmann
Feb 14, 2017 2:39 pm

Currency gyrations, especially the declining British pound, are prompting European finance chiefs to increase their hedging of foreign exchange exposures. According to experts, European companies began raising their hedges after the vote for Brexit in June, and then took on additional positions following the U.S. election in November. Experts see increased hedging in the offing, as political uncertainties increase, said Wolfgang Koester, CEO of FIREapps, a foreign exchange management firm. "Ninety percent of companies we talk to plan to increase their hedge ratios," he said.

The U.S. dollar, euro and pound exchange rates have experienced major swings recently, with the dollar in early January hitting a 14-year high. It then retreated following comments by then President-elect Donald Trump according to which the currency was "too strong".

After the U.K.'s vote for Brexit 2016, the pound slumped to levels not seen since 1985. It remains down around 17% against the dollar and over 11% against the euro compared to its June 23 peak.

"No one knows where currencies are going," said Nancy Ward, finance director at ABC Ltd., a British super computer retailer that operates 60 stores outside the U.K. Among the hedging tool, forward contract, foreign exchange swap and cross-currency basis swap have been widely used. This company sold a super computer to the DEF Ltd. in the United States on credit and invoiced $10 million payable in six months. Currently, the six-month forward exchange rate is $1.10/€ and the foreign exchange advisor for ABC Ltd. predicts that the spot rate is likely to be $1.05/€ in six months.

Source: Adapted from "As Foreign Currencies Swing, CFOs Hedge" at https://blogs.wsj.com/cfo/2017/02/14/as-foreign-currencies-swing-cfos-hedge/

a. From the passage, the declining British pound is prompting European finance chiefs to increase their hedging of foreign exchange exposures. In your opinion, how the declining British pound affects European companies' net profit? Explain with **FOUR (4)** examples. (20 marks)

b. With a diagram, explain the difference between foreign exchange swap and cross-currency basis swap. (8 marks)

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c. For ABC Ltd., what is the expected gain/loss from the forward hedging? Based on your answer, would you recommend hedging this dollar receivable? Why or why not? (8 marks)

d. Suppose the foreign exchange advisor predicts that the future spot rate will be the same as the forward exchange rate quoted today. Would you recommend hedging in this case? Why or why not? (4 marks)

(Total: 40 marks)

QUESTION 2

a. Assume that foreign investors have purchased a significant portion of country ABC's Treasury bond issues. Define the balance of payments (BOP) and discuss the short term and long-term effects of foreigners' portfolio investment on ABC's BOP. (10 marks)

b. Assume that XYZ Co. has net receivables of 100,000 Singapore dollars in 360 days. The spot rate of the S$ is $0.50, and the Singapore interest rate is 2% over 360 days. The United States (U.S.) interest rate is 3%. Suggest how XYZ Co. could implement a money market hedge with calculation. (10 marks)

(Total: 20 marks)

QUESTION 3

a. Define the Fisher Effect and the International Fisher Effect. How are these effects similar and how are they different? (10 marks)

b. Assume that the Citibank trading room is dealing on the following quotations:

> Spot Sterling = $1.5000, Euro-Sterling interest rate (6-months) = 11.00% p.a. Euro-$ interest rate (6-months) = 6.00% p.a. and that Barclays Bank is quoting Forward Sterling (6-months) at $1.5100.

How much profit would you expect to make from a risk-free covered interest arbitrage? Assume that you have Sterling 666,666.67 or equivalent. (10 marks)

(Total: 20 marks)

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QUESTION 4

a. ABC has its U.S. business funded with dollars with a capital structure of 60% debt and 40% equity. It has its Thailand business funded with Thai baht with a total debt of Thai baht 100 million. This debt represents 35% of its total capital in Thailand and its effective tax shield is 40%. The risk-free rate in US$ is 5.75% while in Thai baht is 1.25%. ABC's equity portfolio beta is 1:10. The market risk premium is 4%. Thailand has an inflation rate of 6% while it is 4% in the U.S.

Using information above, estimate the weighted average cost of capital (WACC) for ABC's subsidiary in Thailand. (8 marks)

b. Analyse the linkage between cost and market segmentation; cost and availability of capital; market segmentation and availability of capital. (12 marks)

(Total: 20 marks)

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